

**MISSOURI STATE AUDITOR'S OFFICE
FISCAL NOTE (14-099)**

Subject

Initiative petition from Marc Ellinger regarding a proposed constitutional amendment to Article X. (Received December 23, 2013)

Date

January 13, 2014

Description

This proposal would amend Article X of the Missouri Constitution.

The amendment is to be voted on in November 2014.

Public comments and other input

The State Auditor's office requested input from the **Attorney General's office**, the **Department of Agriculture**, the **Department of Economic Development**, the **Department of Elementary and Secondary Education**, the **Department of Higher Education**, the **Department of Health and Senior Services**, the **Department of Insurance**, **Financial Institutions and Professional Registration**, the **Department of Mental Health**, the **Department of Natural Resources**, the **Department of Corrections**, the **Department of Labor and Industrial Relations**, the **Department of Revenue**, the **Department of Public Safety**, the **Department of Social Services**, the **Governor's office**, the **Missouri House of Representatives**, the **Department of Conservation**, the **Department of Transportation**, the **Office of Administration**, the **Office of State Courts Administrator**, the **Missouri Senate**, the **Secretary of State's office**, the **Office of the State Public Defender**, the **State Treasurer's office**, **Adair County**, **Boone County**, **Callaway County**, **Cass County**, **Clay County**, **Cole County**, **Greene County**, **Jackson County Legislators**, **Jasper County**, **St. Charles County**, **St. Louis County**, **Taney County**, the **City of Cape Girardeau**, the **City of Columbia**, the **City of Jefferson**, the **City of Joplin**, the **City of Kansas City**, the **City of Kirksville**, the **City of Kirkwood**, the **City of Mexico**, the **City of Raymore**, the **City of St. Joseph**, the **City of St. Louis**, the **City of Springfield**, the **City of Union**, the **City of Wentzville**, the **City of West Plains**, **Cape Girardeau 63 School District**, **Hannibal 60 School District**, **Rockwood R-VI School District**, **Linn State Technical College**, **Metropolitan Community College**, **University of Missouri**, **St. Louis Community College**, **University of Central Missouri**, **Harris-Stowe State University**, **Lincoln University**, **Missouri State University**, **Missouri Southern State University**, **Missouri Western State University**, **Northwest Missouri State University**, **Southeast Missouri State University**, and **Truman State University**.

Assumptions

Officials from the **Attorney General's office** indicated they assume that any potential costs arising from the adoption of this proposal can be absorbed with existing resources.

Officials from the **Department of Economic Development** indicated no impact for their department.

Officials from the **Department of Elementary and Secondary Education** indicated:

Section 26

In addition to all other taxes imposed on tobacco products, an additional special assessment of \$0.17 per package of 20 cigarettes shall be paid by the wholesaler. The proposal also imposes a new special assessment in the amount of \$0.034 on the sale of every vapor product unit. In addition, an equity assessment fee is imposed upon the purchase, storage, use, consumption, handling, distribution or wholesale of non-participating manufacturer cigarettes at the rate of \$0.55 per package of 20 cigarettes. We defer to DOR in regard to collection amounts resulting from the assessments and fees.

Section 27

The individual income tax is reduced per "reduction factor" (i.e. the percentage, rounded to the nearest tenth of one percent but not less than one tenth of one percent, sufficient to reduce tax collections by the amount collected from the fees or assessments imposed). The existing rate of the individual income tax shall be permanently reduced by the reduction factor effective the immediately ensuing tax year. If the existing rate of the individual income tax is one tenth of one percent or less, then the individual income tax shall be permanently eliminated and the general assembly shall not have the authority to impose a tax on or measured by income or earnings of an individual.

Summary

All revenues generated shall be used to reduce the individual income tax. Based on this assumption, the state school foundation formula would not be negatively impacted fiscally. However, the proposal appears to address the reduction and/or permanent elimination of the individual income tax rate. It does not appear to allow for an increase or adjustment to the individual income tax rate when the collection of assessments and fees are insufficient to cover the reduction factor in any previous year. This could ultimately lead to a situation where there are minimal taxes collected from individual income taxes and minimal collections from the assessments and fees created here, such that state revenues could be significantly diminished. This would negatively impact the state school foundation formula.

Officials from the **Department of Higher Education** indicated this proposal would not result in any costs or savings for their department. Although the petition would levy new taxes, it appears the adjustment to other taxes would result in a zero total impact. In any

regard, the potential change in revenue is unknown and would not constitute a savings to their department.

Officials from the **Department of Health and Senior Services** indicated this initiative petition is a no impact note for their department.

Officials from the **Department of Insurance, Financial Institutions and Professional Registration** indicated this petition, if passed, will have no cost or savings to their department.

Officials from the **Department of Mental Health** indicated this proposal creates no direct obligations or requirements to their department that would result in a fiscal impact.

Officials from the **Department of Natural Resources** indicated they would not anticipate a direct fiscal impact from this proposal.

Officials from the **Department of Corrections** indicated no impact for their department.

Officials from the **Department of Labor and Industrial Relations** indicated no fiscal impact to their department.

Officials from the **Department of Revenue** indicated increased operating costs for the department will be \$258,724 for fiscal year 2015, \$206,774 for fiscal year 2016, and \$208,925 for fiscal year 2017.

The IT portion of this fiscal impact is estimated with a level of effort valued at \$55,037. This value is based on 2,016 FTE hours.

This amendment may result in decrease in Total State Revenue. While the increase due to the \$0.034 tax on vapor product units is unknown, the \$0.17 assessment fee on all cigarette packages will increase revenues by \$88.5 million the first year the amendment goes into effect. The \$0.55 assessment fee on all non-participating manufacturer cigarettes will result in an increase of \$71.2 million. This increase will result in a reduction in the individual income tax rate of 0.3 percent, decreasing general revenue by an estimated \$206.3 million. The Department assumes that the assessments charged to vapor unit products and non-participating manufacturer cigarette packages will be deposited into the General Revenue fund, resulting in a net loss of \$46.6 million dollars to general revenue.

The increase in assessments on vapor products and cigarettes increases state revenues. But, if the amendment permanently reduces individual income based on the increased assessments and then vapor products and cigarette sales decrease, this may lead to a decrease in state revenues.

Section 26

This version of the petition adds an additional \$0.17 per pack special assessment on cigarettes purchased after the effective date of this amendment. This section also proposes a new assessment of \$0.034 on vapor product units, and an additional \$0.55 assessment on all non-participating manufacturer cigarettes. The revenue generated from these assessments reduces the individual income tax.

In calendar year 2012, 536.5 million packages of cigarettes were reported as being stamped for sale in the state of Missouri. The \$0.17 assessment fee will increase revenues by an estimated \$88.5 million, assuming the wholesalers receive the 3 percent discount established in Chapter 149, RSMo. The department has no information on the number of vapor product units sold in the state. OA-BP may be able to provide more information on the impact of this assessment.

In calendar year 2012, 133.4 million non-participating manufacturer cigarette packages were sold. The \$0.55 assessment on all will increase revenues by \$71.2 million dollars, assuming wholesalers receive the 3 percent discount.

If revenues are increased due to these assessments, the individual income tax rate will be reduced to 5.7 percent, resulting in a loss to general revenue of \$206.3 million dollars the first year the rate is reduced.

In addition to the above assessments, the petition makes any person that, for commercial purposes, operates or maintains a machine that allows persons to process a cigarette a manufacturer. The resultant product from this process is considered a cigarette.

Section 27

This section permanently reduces individual income tax by the amount collected by the state from the assessments imposed in Section 26.

Administrative Impact:

Personal Tax:

Section 27

Personal Tax requires programming support and forms changes. Additionally, one (1) Revenue Processing Technician I will be required to process correspondence.

Collections & Tax Assistance (CATA):

Based on Section 27(b), CATA anticipates additional customer contacts due to the tax rate change and adjustment notices. CATA requires two (2) Tax Collection Technicians I for additional contacts on the non-delinquent and delinquent tax lines and one (1) Revenue Processing Technician I for contacts to the field offices. Each technician requires CARES equipment and licenses.

Excise Tax:

Section 26(b)

Depending on who collects the tax, either 250 licensed wholesalers or approximately 4,500 retailers need to be notified of the provisions of this amendment. New reporting forms would need to be developed and a program would be needed to track the information.

Excise Tax requires one (1) Revenue Processing Technician I for every 3,000 returns.

Section 26(c)

The department assumes that all revenues collected would go to the general revenue fund. This would require changes to the cashiering functions and to SAM II entry.

Section 26(e)

This section requires a Constitutional Amendment for any future increase to the tax, license, fee or special assessment on cigarettes or tobacco products.

Section 26(g)

New reporting forms would need to be developed, 120 cigarette wholesalers would need to be notified, the Peach Tree Accounting System would require updating to allow for the tax rate and changes would need to be made to cashiering functions and to SAM II entry.

ITSD-DOR:

Individual: Tax rate reduction – 504 hours

Excise: New Vapor Product Excise Tax system – 1008 hours

New assessment on non-participating manufacturer cigarettes – 504 hours

Total: 2,016 FTE Hours

Comments:

Section 26

Although it is not stated within this amendment, the department assumes that the assessments collected within this section will be deposited into the General Revenue fund to offset the loss of funds due to the individual income tax rate reduction.

Currently, the department collects other tobacco products tax on the manufacturer's invoice price of a product. The petition bases special assessment on vapor product units, which are defined as .05 fluid ounces of specified material.

Internet research indicates most material containing nicotine is measured in milliliters (ml) not ounces. Therefore, conversion will be needed to determine the special assessment amount based upon ounces. Additionally electronic cigarette kits contain cartridges containing small amounts of fluid (usually somewhere between 3 to 7 drops). This may be difficult to calculate the amount due.

It is also unclear if the vapor product unit must contain at least .05 ounces. It is unclear if a kit that contains two cartridges that hold less than .05 ounces is still subject to assessment. The department assumes that the assessment can be based upon a fractional part of .05 ounces. The department also assumes that if a product contains 30 ml then that would be converted to ounces and divided by .05 to determine the number of "Vapor Product Units" subject to assessment.

The language is unclear as to who would be responsible for remitting the special assessment on vapor product units, the wholesaler or the retailer.

If the FDA regulates these products under Chapter V of the Food, Drug and Cosmetics Act, they would no longer be subject to the special assessment.

It is unclear if the person responsible for collecting the special assessment would need to be licensed or not. If licensing of retailers is required, additional personnel will be needed. Additionally, if licensing is required, it is unclear if the requirements in Chapter 149, which impose a yearly fee and requiring submission of a bonding instrument, apply.

There does not appear to be any penalty provisions for non-compliance. It is unclear if the person remitting the tax will be granted any collection allowances. There are no refund provisions. The legislature is not authorized to enact any implementing legislation.

The department assumes the effective date of this legislation would be upon certification of the election results by the Secretary of State. This would not allow sufficient time to make all the necessary form changes, programming changes and notifications. It is recommended that the effective date be changed to July 1, 2015.

Current cigarette taxes are imposed upon the consumer. This legislation appears to impose the tax on the wholesaler, making the assessment fee subject to sales tax. This may be confusing to retailers, as they currently do not charge sales tax on the state cigarette tax.

As this legislation requires that the assessment be collected in the same manner as other cigarette tax, this would require the design and purchase of new cigarette stamps to be used only on non-participating manufacturer cigarettes. Because of the special assessment in this section, an additional series of stamps would have to be designed and purchased. Requiring separate stamps would put a burden on the wholesaler.

The department budgets for and purchases all cigarette stamps for the fiscal year at one time. The implementation of a new tax at a time other than the beginning of a fiscal year could result in inventory of stamps that will be obsolete and would have to be destroyed. Additionally there may not be sufficient funds in the budget to allow the purchase of the new stamps.

The department assumes that the compensation allowance of 3 percent provided for in Chapter 149.021 RSMo would apply to the special assessment fee as the fee is to be

collected in the same way as other cigarette taxes. The department also assumes that this would allow for the credit or refund on returned stamps.

The department assumes that any use of rolling machines in a commercial setting under Section 26(g), which would include private or social clubs, will be considered manufacturing cigarettes.

Section 27

This section allows for the individual income tax to be permanently reduced. However it does not provide for any increase if in future years the revenues for the special assessments imposed in Section 26 decreases. It is also unclear if the rate reduction occurs if the assessment amounts collected remain the same from year to year. The language is also vague as to who is responsible for determining whether the decrease is reoccurring.

Officials from the **Department of Social Services** indicated there is no direct fiscal impact to their department. Since the budget of any state agency is dependent upon the appropriations process, they cannot predict whether their department might be affected if this proposal were to result in a change in the total amount of general revenue available to fund state government.

Officials from the **Governor's office** indicated there should be no fiscal impact to their office.

Officials from the **Missouri House of Representatives** indicated there should be no fiscal impact to their agency as a result of the passage of this initiative petition.

Officials from **Department of Conservation** indicated that no adverse fiscal impact to their department would be expected as a result of this proposal.

Officials from the **Department of Transportation** indicated they assume no fiscal impact from this initiative petition.

Officials from the **Office of Administration** indicated:

These proposals create, upon voter approval, additional taxes on various tobacco products.

There should be no cost to the Office of Administration.

Budget & Planning (BAP) provides these estimates:

Vapor Product Units (all versions):

The proposals create an additional tax of \$0.034 levied on each "Vapor Product Unit" (VPU), defined as 0.05 fl. oz. of nicotine product.

- According to a recent analysis by Wells Fargo Securities,¹ national sales of e-cigarettes will total \$1.7 billion in 2013.
- BAP assumes 2% of this figure represents sales in MO, and of this, 90% is sales of VPUs, or about \$32M.
- BAP assumes these sales are in the form of "cartridges" that retail for \$2 each, or 16M cartridges. Also, each cartridge contains 1.5 mL of liquid, for a total of 24M mL. However, there are numerous e-cigarette products, with various amounts of fluid, offered at an array of prices for consumers to choose from.
- BAP notes that 24M mL is about 0.812M fl. Oz,² which implies about 16.231M VPUs are sold in MO.
- At \$0.034 per VPU, this would generate about \$0.552M in additional revenues.

Cigarette Tax (versions 97, 98, 99):

The proposals create an additional cigarette tax of \$0.17 per pack, which doubles the current rate of tax. BAP notes that cigarette tax revenues in FY13 totaled just over \$86.8M. However, the additional tax would reduce the number of units sold. BAP estimates this additional tax would generate \$81.8M of revenues.

Equity Assessment Fee for NPMs (all versions):

The proposals create an Equity Assessment Fee of \$0.55 per pack for the sale of Non-Participating Manufacturer cigarettes. The DOR may have an estimate of the revenue that may be generated.

Rolling Taxes (all versions, v. 96&99 match, and v. 97&98 match).

The proposals stipulate that any operator of a machine that allows any person to process tobacco into a roll or tube, or that provides access to such machinery, is a manufacturer. This may increase revenues, to the extent that sellers of rolling services remit taxes based on stamped products, instead of paying the "other tobacco products" taxes they may currently be paying.

Income Tax Reduction Factor (all versions):

The proposals require the existing rate of the individual income tax to be reduced by a "reduction factor." There are several marginal income tax rates in statute; BAP assumes this proposal refers to the top marginal rate in effect. The "reduction factor" means the percentage, rounded to the nearest tenth, but not less than 0.1%, sufficient to reduce collections by an amount equal to the tobacco taxes collected above. Based on 2011 Tax Year data, BAP estimates each 0.1% reduction may reduce revenues by \$69M or more, depending on the rate in effect. Thus, the "reduction factor" may be rounded up to as much as 0.3%, for a reduction of at least \$207M. Therefore, it is possible the reduction in income taxes may exceed the new tobacco revenues.

The reduction factor is be based on the new tobacco revenues collected in "any state fiscal year," as described in proposed subsection 27(a). Further, the proposed subsection

¹ http://www.cnbc.com/id/100991511#_gus

² <http://www.convertunits.com/from/fluid+ounces/to/ml>

27(b) requires the income tax rate to be "permanently reduced" effective the immediately ensuing tax year. This could be interpreted to mean that the rate of income tax is reduced every year, even if the collection of tobacco taxes remains stable or decreases, or if income taxes declines because of economic conditions. This situation is further implied in proposed subsection 27(c), which requires the elimination of the income tax if the existing rate is 0.1 percent or less. It might follow that this proposal eliminates the income tax in twenty to sixty years, so long as any of the proposed tobacco revenues continue to be collected, eliminating \$6 billion in revenue based on current collections.

Other Comments:

The reduction in income tax rates will reduce general revenues. However, it is unclear from this proposal if the new tobacco revenues will be deposited into general revenue or other dedicated funds.

Any reduction in the number of tobacco products sold may also reduce sales taxes. This would further reduce general revenues, as well as those for schools and other dedicated funds.

Officials from the **Office of State Courts Administrator** indicated there is no fiscal impact on the courts.

Officials from the **Missouri Senate** indicated this initiative petition has zero fiscal impact to their office.

Officials from the **Secretary of State's office** indicated their office is required to pay for publishing in local newspapers the full text of each statewide ballot measure as directed by Article XII, Section 2(b) of the Missouri Constitution and Section 116.230-116.290, RSMo. Their office is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. Funding for this item is adjusted each year depending upon the election cycle with \$1.3 million historically appropriated in odd numbered fiscal years and \$100,000 appropriated in even numbered fiscal years to meet these requirements. The appropriation has historically been an estimated appropriation because the final cost is dependent upon the number of ballot measures approved by the General Assembly and the initiative petitions certified for the ballot. In FY 2013, at the August and November elections, there were 5 statewide Constitutional Amendments or ballot propositions that cost \$2.17 million to publish (an average of \$434,000 per issue). Therefore, their office assumes, for the purposes of this fiscal note, that it should have the full appropriation authority it needs to meet the publishing requirements. However, because these requirements are mandatory, they reserve the right to request funding to meet the cost of their publishing requirements if the Governor and the General Assembly change the amount or eliminate the estimated nature of our appropriation.

Officials from the **Office of the State Public Defender** indicated this initiative petition will not have any substantial impact on their office other than if revenues are significantly changed.

Officials from the **State Treasurer's office** indicated no fiscal impact to their office.

Officials from the **City of Jefferson** indicated there is not expected to be a fiscal impact to their city.

Officials from the **City of Kansas City** indicated this initiative petition would have no fiscal impact on their city.

Officials from the **City of Raymore** indicated no fiscal impact.

Officials from the **City of St. Joseph** indicated as increase in cigarette taxes could negatively impact revenues should customers find it less expensive to hop over to Kansas and purchase cigarettes there.

As of now, the tax on "vapor products" would have no impact on city finances one way or another. Should the city ever enact a personal income tax, the proposed reduction factor could negatively impact revenues with no corresponding revenues from the new special assessment tax to replace them.

Officials from the **Hannibal 60 School District** indicated it is their belief that, if passed, this initiative petition would have a negative impact on Elementary and Secondary Education. The permanent reduction of taxes could negatively impact education for many years to come.

Officials from **University of Missouri** indicated the fiscal impact on their university would be tax neutral in that additional revenues generated will be used to reduce the individual income tax.

Officials from the **University of Central Missouri** indicated they estimate no fiscal impact from this initiative petition.

Officials from **Northwest Missouri State University** indicated no impact.

The State Auditor's office did not receive a response from the **Department of Agriculture, the Department of Public Safety, Adair County, Boone County, Callaway County, Cass County, Clay County, Cole County, Greene County, Jackson County Legislators, Jasper County, St. Charles County, St. Louis County, Taney County, the City of Cape Girardeau, the City of Columbia, the City of Joplin, the City of Kirksville, the City of Kirkwood, the City of Mexico, the City of St. Louis, the City of Springfield, the City of Union, the City of Wentzville, the City of West Plains, Cape Girardeau 63 School District, Rockwood R-VI School District, Linn State Technical College, Metropolitan Community College, St. Louis Community College, Harris-Stowe State University, Lincoln University, Missouri State University, Missouri Southern State University, Missouri Western State University, Southeast Missouri State University, and Truman State University.**

Fiscal Note Summary

Taxes and fees collected annually under the proposal are used to calculate permanent reductions to the individual income tax rate. This process over several decades could eliminate the individual income tax, which would be approximately \$6 billion in annual revenue based on current collections. Whether the proposal will be revenue neutral cannot be determined.